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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into the Review
of the California High Cost Fund B Program.

Rulemaking 06-06-028
(Filed June 29, 2006)

**ASSIGNED COMMISSIONER'S RULING
REGARDING THE SCOPING AND SCHEDULING OF PHASE II ISSUES**

1. Introduction

This ruling provides notice and opportunity to comment regarding the scope of issues and procedural schedule for addressing issues in Phase II of this proceeding, as identified in Decision (D.) 07-09-020. A preliminary "Assigned Commissioner's Ruling" (ACR), previously issued on September 12, 2007, addressed Phase II issues regarding the California Advance Services Fund (CASF) program for deployment of broadband in areas that are not served or are underserved. This ruling addresses the scope and schedule for remaining Phase II issues.

We prioritize remaining Phase II issues in the following manner: An opening-and-reply round of comments shall be scheduled on the implementation of a reverse auction and updating of high-cost proxies. Because of the interrelated nature of these measures, comments will be due concurrently. Other Phase II issues shall be considered in a separate round of comments, as identified below.

2. Coordination of Reverse Auction and Cost Proxy Model Updating

In D.07-09-020, the Commission directed that implementation of a reverse auction mechanism be addressed in Phase II of this proceeding as a basis for setting high-cost support levels for basic service. With a reverse auction, eligible carriers will bid on the level of support per line that they require to provide basic service as a carrier of last resort (COLR) in specified high-cost areas. Bids will be made in descending order, with the lowest qualifying bid being accepted as the basis for payment of B-Fund support levels within the designated area.

Another Phase II issue involves the updating of relevant high-cost proxies utilizing the HM 5.3 Model. As noted in D.07-09-020, a reverse auction is a superior approach to setting high-cost support levels compared with HM 5.3 Model updating, and deserves priority, particularly given the limitations of the HM 5.3 Model which is based on traditional voice-centric technology. A properly structured auction mechanism will provide more market-based support levels, as compared with cost models. The use of an auction eliminates debates over the type of technology to be modeled. A reverse auction can reduce subsidy levels to the extent that a winning bid is below support levels derived from a cost proxy model.

Nonetheless, the Commission recognized that it may be necessary to proceed with cost proxy updating at least on a limited basis in coordination with implementing the reverse auction. Accordingly, comments are solicited on the appropriate manner in which to sequence and prioritize respective tasks involved in implementing a reverse auction and updating relevant high-cost proxies, recognizing the inherent limitations in the HM 5.3 modeling approach. In this way, the relevant considerations can be assessed in coordinating implementation of the reverse auction and cost proxy updates. The updating of

cost proxies may be a transitional step toward the implementation of the reverse auction.

2.1. Reverse Auction Design and Implementation

We also solicit comments on the specific design and implementation of a reverse auction mechanism to determine B-Fund subsidy support levels and COLR status as a means of funding high cost support. Following review of comments on questions below, we intend to schedule a technical workshop as a forum to build consensus on the design and implementation of a reverse auction. Parties' comments will identify areas of agreement and also highlight issues requiring further analysis. We thus solicit comments on the following questions:

1. Are there any statutory limitations to designating COLRs through an auction process?
2. What processes and protocols should be established to implement a reverse auction for purposes of assigning COLR obligations and setting the level of subsidy support in high-cost areas served by the existing incumbents? Is a descending bid, simultaneous-close auction the best type of auction to determine support?
3. The auction mechanism will require a bidding process predicated upon appropriate parameters of acceptable COLR service. What eligibility criteria for carriers and service quality standards should be established as a basis for reverse auction bidding? For example, what minimum standard of reliable 911 service would be necessary to qualify as a COLR as a result of a reverse auction bid? Should COLR status be granted for only a limited time subject to periodic renewal? If so, what should be the duration of COLR status?
4. Should threshold standards, such as financial fitness, be adopted to qualify to bid in the auction? Should there be a bond required?

5. What sorts of regulatory compliance requirements should apply to a selected bidder? Should reliability standards be placed on COLRs? What Commission audit requirements may be warranted to verify and confirm that a winning bidder follows through with commitments to meet such specified minimum basic service quality standards? Should any penalties for withdrawal, such as the difference between the winning bid amount and the next carrier or reauction bid amount, be imposed?
6. What service(s) should be included within the bid covered by the reverse auction? (Parties may incorporate, by reference, comments on CASF issues, to the extent deemed relevant.) What limitations or conditions should be placed on service(s) that may be included within (or excluded from) the bidding? Are there other elements that should be part of bid than the amount of universal service support for the specific area? Should bids to be placed on total support, support per subscriber, support per household, or some other basis?
7. In what geographic area(s) should the initial auctions be held? How many separate auctions will be required? What is the appropriate transition time to phase-out existing COLR support and phase-in new COLR support? Should the same timeframe be used to phase-in coverage and other COLR obligations? Should build-out benchmarks be established?
8. Should one particular area be selected for a pilot project to test the operation of a reverse auction? If so, based upon what considerations?
9. Should only one COLR be selected for each area, or should reduced subsidies be available to qualifying competitive carriers?
10. Should the size of the service area subject to reverse auction bidding be set by the Commission or determined by the bidding process?
11. What is a reasonable cost proxy to serve as an initial auction “reserve” or upper bound on bids that would be acceptable as the basis for payment of support levels? What is the most expeditious manner to derive an appropriate benchmark for

- setting such upper bounds? As a default, should any qualifying upper bid be at or below the existing B-Fund support level for designated areas subject to the auction? If the HM 5.3 Model is used to designate areas subject to the auction, should a cap be placed on the results? What is a reasonable cap?
12. What sorts of cost proxy determinations or updates may be necessary or desirable as a basis to identify areas subject to bidding under the reverse auction? Is there a better approach to forecast service needs of the area for the duration of the COLR designation?
 13. If an existing ILEC COLR does not submit a selected bid during the auction, should there be any additional requirements that the ILEC make its existing facilities in the designated area available to a new COLR?

2.2. Cost Proxy Model Update Implementation

We also solicit comments on the process to update cost proxies utilizing the HM 5.3 Model for qualifying High Cost Census Block Groups for each of the COLRs. Because our priority is to implement a reverse auction, we shall consider the timing, nature, and extent of cost proxy model updating primarily in the context of providing necessary parameters for setting the appropriate bounds of reverse auction bids, and/or to provide cost support in areas where the auction has not yet been implemented or where no carrier bids to provide basic service below the cost proxy level.

Following review of parties' comments, both on the reverse auction as well as on the cost proxy model process, we shall consider the timing of further steps to implement necessary cost proxy updating, including the need for a cost modeling technical workshop. As noted above, however, our first priority will be to convene a workshop to address the reverse auction. In view of the limited

context in which we intend to proceed with implementation of the HM 5.3 model update, preliminary comments are solicited as follows:

1. In order to mitigate the risks that the HM 5.3 Model may produce anomalous results, how, or in what manner, should the total investment calculation produced by the HM 5.3 Model be capped to avoid excessive subsidies?
2. Why should any other adjustments be considered?
3. What other possible adjustments to the cost proxy should be considered in order to avoid excessive subsidies, (e.g., limiting support only to the operations and maintenance costs for existing lines as derived from the model)?
4. What other adjustments to the HM 5.3 model may be appropriate to streamline the updating process while ensuring that the resulting cost proxies are reasonable for deriving B-Fund support levels as an interim transition to the reverse auction?
5. What procedural measures may be necessary in order to facilitate the timely production of cost model runs, provision for discovery, protection of proprietary data, and other measures to develop an adequate record on cost model updates?

3. Other Phase II Issues

We shall solicit a separate round of comments on the following additional Phase II issues as identified in D.07-09-020.

3.1. Transitional Basic Rate Caps

The rates for basic service charged by each of the ILECs subject to the B-Fund are currently subject to a freeze. In D.07-09-020, the Commission established a process for the freeze to be lifted and for basic rates to transition toward full pricing flexibility through gradual step increases in existing rate caps for each ILEC. The magnitude of the step increases in the rate cap and the duration of the transition process are matters to be determined in Phase II. Accordingly, comments are solicited on the following questions:

(a) To promote an orderly transition and prevent sudden large rate increases, what maximum level above the currently authorized caps should be set as the revised cap on basic rates for each respective ILEC before full pricing flexibility is to take effect?

(b) What period of time is appropriate for the phase-in of increases in the caps on ILEC basic rates to transition from current levels to a level at which further cap restrictions can be eliminated and full pricing flexibility implemented?

Provide appropriate supporting rationale for each proposal concerning rate caps and duration of the phase-in period.

3.2. Certification Process to Quality for B-Fund Support

What process should be implemented whereby the COLR shall certify that its services and rates in high cost areas are reasonably comparable to services offered in urban areas once full pricing flexibility takes effect?

3.3. Broadening the Base for Eligibility to Receive B-Fund support

Should existing rules for eligibility to receive B-Fund support be modified to accommodate a broader base of eligibility for B-Fund support to include wireless and other intermodal carriers? Comments are solicited as to the merits of such a modification as a way to promote competitive neutrality in the allocation of B-Fund support, consistent with public policy goals. What other considerations or revisions in existing rules may be appropriate or necessary to accommodate such a change?

3.4. Standards/Procedures for Future Period Review of the B-Fund Program

What standards and procedures should be applied for future periodic review of the B-Fund program in order to ensure that the program continues to be effective in meeting the Commission's universal service goals?

3.5. Streamlined Administration of B-Fund Receipts and Disbursements

Through what standards and procedures can the administration of the B-Fund program be made more streamlined and efficient?

Therefore, **IT IS RULED** that:

1. Comments on sequencing, coordination, design and implementation issues relating to the reverse auction mechanism and cost proxy model updating, as identified above, shall be due on October 31, 2007. Reply comments shall be on November 9, 2007.

2. Following receipt of comments, a technical workshop shall be scheduled setting forth an agenda for building consensus on the design and implementation of a reverse auction. The need for a separate technical workshop shall be considered to address cost model proxy updating issues in coordination with the reverse auction implementation.

3. Comments on other Phase II issues, as set forth above, shall be due on November 5, 2007 and reply comments shall be due on November 15, 2007

Dated October 5, 2007, at San Francisco, California.

/s/ RACHELLE B. CHONG

Rachelle B. Chong
Assigned Commissioner